



Interim Audit Report of the Audit Division on the California Republican Party/V8 January 1, 2007 – December 31, 2008

Why the Audit Was Done

Federal law permits the Commission to conduct audits and field investigations of any political committee that is required to file reports under the Federal Election Campaign Act (the Act). The Commission generally conducts such audits when a committee appears not to have met the threshold requirements for substantial compliance with the Act.¹ The audit determines whether the committee complied with the limitations, prohibitions and disclosure requirements of the Act.

Future Action

The Commission may initiate an enforcement action, at a later time, with respect to any of the matters discussed in this report.

About the Committee (p. 2)

The California Republican Party/V8 is a state party committee headquartered in Burbank, California. For more information, see the chart on the Committee Organization, p. 2.

Financial Activity (p. 2)

• Receipts	
○ Contributions from Individuals	\$ 6,367,753
○ Contributions from Other Political Committees	87,646
○ Transfers from Affiliated Party Committees	7,557,282
○ Transfers from Non-federal and Levin Accounts	3,389,660
○ Other Receipts	188,928
Total Receipts	\$ 17,591,269
• Disbursements	
○ Operating Expenditures	\$ 11,110,199
○ Transfers to Affiliated/Other Party Committees	3,968,892
○ Contributions to Federal Candidates	30,000
○ Coordinated Party Expenditures	41,660
○ Federal Election Activity	2,392,956
○ Contribution Refunds	33,688
Total Disbursements	\$ 17,577,395
• Levin Receipts	\$ 620,349
• Levin Disbursements	\$ 624,378

Findings and Recommendations (p. 3)

- Misstatement of Levin Financial Activity (Finding 1)
- Reporting of Debts & Obligations (Finding 2)
- Extension of Credit by a Commercial Vendor (Finding 3)

¹ 2 U.S.C. §438(b).

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Part I

Background

Authority for Audit

This report is based on an audit of the California Republican Party/V8 (CRP), undertaken by the Audit Division of the Federal Election Commission (the Commission) in accordance with the Federal Election Campaign Act of 1971, as amended (the Act). The Audit Division conducted the audit pursuant to 2 U.S.C. §438(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 2 U.S.C. §434. Prior to conducting any audit under this subsection, the Commission must perform an internal review of reports filed by selected committees to determine if the reports filed by a particular committee meet the threshold requirements for substantial compliance with the Act. 2 U.S.C. §438(b).

Scope of Audit

Following Commission-approved procedures, the Audit staff evaluated various risk factors and as a result, this audit examined:

1. the disclosure of individual contributors' occupation and name of employer;
2. the disclosure of disbursements, debts and obligations;
3. the disclosure of expenses allocated between federal, non-federal, and Levin accounts;
4. the consistency between reported figures and bank records;
5. the completeness of records; and
6. other committee operations necessary to the review.

Part II

Overview of Committee

Committee Organization

Important Dates	
• Date of Registration	March 5, 1981 ²
• Audit Coverage	January 1, 2007 – December 31, 2008
Headquarters	
Burbank, California	
Bank Information	
• Bank Depositories	One
• Bank Accounts	Four Federal, Two Levin & Ten Non-federal Accounts
Treasurer	
• Treasurer When Audit Was Conducted	Keith Carlson
• Treasurer During Period Covered by Audit	Keith Carlson
Management Information	
• Attended FEC Campaign Finance Seminar	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

Overview of Financial Activity (Audited Amounts)

Cash-on-hand @ January 1, 2007	\$ 66,827
○ Contributions from Individuals	6,367,753
○ Contributions from Other Political Committees	87,646
○ Transfers from Affiliated Party Committees	7,557,282
○ Transfers from Non-federal and Levin Accounts	3,389,660
○ Other Receipts	188,928
Total Receipts	\$ 17,591,269
○ Operating Expenditures	11,110,199
○ Transfers to Affiliated/Other Party Committees	3,968,892
○ Contributions to Federal Candidates	30,000
○ Coordinated Party Expenditures	41,660
○ Federal Election Activity	2,392,956
○ Contribution Refunds	33,688
Total Disbursements	\$ 17,577,395
Cash-on-hand @ December 31, 2008	\$ 80,701
Levin Cash-on-hand @ January 1, 2007	
Total Levin Receipts	\$ 620,349
Total Levin Disbursements	\$ 624,378
Levin Cash-on-hand @ December 31, 2008	\$ 7,293

² CRP originally registered with the Secretary of the Senate on August 7, 1974, as the Republican State Central Committee of California Federal Election Account, under a different identification number. This previous committee terminated on August 5, 1981, shortly after the formation of the current Committee.

Part III

Summaries

Findings and Recommendations

Finding 1. Misstatement of Levin Financial Activity

During audit fieldwork, a comparison of CRP's reported Levin activity with bank records revealed a material misstatement of receipts and disbursements in 2008. CRP understated receipts and disbursements by \$50,071 and \$54,009, respectively. The Audit staff recommends that CRP amend its disclosure reports to correct the misstatement. (For more detail, see p. 4.)

Finding 2. Reporting of Debts & Obligations

Audit fieldwork indicated that CRP failed to report debts and obligations for 28 vendors totaling \$2,188,950 on Schedule D (Debts and Obligations). The Audit staff recommends that CRP amend its disclosure reports to include these debts and obligations. (For more detail, see p. 5.)

Finding 3. Extension of Credit by a Commercial Vendor

After reviewing and analyzing disbursement records during audit fieldwork, the Audit staff noted that an incorporated vendor appeared to make a prohibited contribution to CRP by extending credit beyond its normal course of business and by failing to make commercially reasonable attempts to collect \$1,171,002 for services rendered. The Audit staff recommends that CRP provide documentation demonstrating that the credit extended to CRP was in the vendor's ordinary course of business and that the vendor made reasonable attempts to collect these debts. (For more detail, see p. 6.)

Part IV

Findings and Recommendations

Finding 1. Misstatement of Levin Financial Activity

Summary

During audit fieldwork, a comparison of CRP's reported Levin activity with bank records revealed a material misstatement of receipts and disbursements in 2008. CRP understated receipts and disbursements by \$50,071 and \$54,000, respectively. The Audit staff recommends that CRP amend its disclosure reports to correct the misstatement.

Legal Standard

A. Reporting. If a state, district or local party committee's combined annual receipts and disbursements for federal election activity (FEA) are \$5,000 or more during the calendar year, then it must disclose receipts and disbursements of Federal funds and Levin funds used for FEA. 11 CFR §300.36(b)(2).

B. Contents of Levin Reports. Each report must disclose:

- The amount of cash-on-hand for Levin funds at the beginning and end of the reporting period;
- The total amount of Levin fund receipts and disbursements (including allocation transfers) for the reporting period and for the calendar year; and,
- Certain transactions that require itemization on Schedule L-A (Itemized Receipts of Levin Funds) or Schedule L-B (Itemized Disbursements of Levin Funds).
11 CFR §300.36(b)(2)(B).

Facts and Analysis

A. Facts

As part of fieldwork, the Audit staff reconciled CRP's reported Levin activity with bank records for 2008. The following chart outlines the discrepancies for the beginning cash-on-hand balance, receipts, disbursements, and the ending cash-on-hand balance. Succeeding paragraphs address the reasons for the misstatements, if known.

2008 Committee Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash-on-Hand Balance @ January 1, 2008	\$14,988	\$14,443	\$545 Overstated
Receipts	\$556,470	\$606,541	\$50,071 Understated
Disbursements	\$559,692	\$613,692	\$54,000 Understated
Ending Cash-on-Hand Balance @ December 31, 2008	\$11,766	\$7,292	\$4,474 Overstated

The beginning cash-on-hand balance was overstated by \$545 and is unexplained, but likely resulted from prior period discrepancies. The \$50,071 understatement of receipts resulted mostly from contributions from individuals that were not reported, the understatement of disbursements by \$54,000 resulted from a vendor payment that was not reported, and the \$4,474 overstatement of the ending cash-on-hand balance was the result of the misstatements previously described.

B. Interim Audit Report & Audit Division Recommendation

The Audit staff discussed the reporting errors and presented relevant work papers to the CRP representative at the exit conference. The representative stated that he would review the matter.

The Audit staff recommends that, within 30 calendar days of service of this report, CRP:

- amend its reports to correct the misstatement for 2008, as noted above; and
 - amend its most recently filed report to correct the cash-on-hand balance with an explanation that the change resulted from a prior period audit adjustment.
- Further, CRP should reconcile the cash balance of its most recent report to identify any subsequent discrepancies that may impact the \$4,474 adjustment recommended by the Audit staff.

Finding 2. Reporting of Debts & Obligations

Summary

Audit fieldwork indicated that CRP failed to report debts and obligations for 28 vendors totaling \$2,188,950 on Schedule D (Debts and Obligations). The Audit staff recommends that CRP amend its disclosure reports to include these debts and obligations.

Legal Standard

A. Continuous Reporting Required. A political committee must disclose the amount and nature of outstanding debts and obligations until those debts are extinguished.

2 U.S.C §434(b)(8) and 11 CFR §§104.3(d) and 104.11(a).

B. Separate Schedules. A political committee must file separate schedules for debts owed by the committee and debts owed to the committee, together with a statement explaining the circumstances and conditions under which each debt and obligation was incurred or extinguished. 11 CFR §104.11(a).

C. Itemizing Debts and Obligations.

- A debt of \$500 or less must be reported once it has been outstanding 60 days from the date incurred (the date of the transaction); the committee reports it on the next regularly scheduled report.
- A debt exceeding \$500 must be disclosed in the report that covers the date on which the debt was incurred. 11 CFR §104.11(b).

Facts and Analysis

A. Facts

During fieldwork, the Audit staff reviewed disbursement records and disclosure reports for proper reporting of debts and obligations. This review identified debts owed to 28 vendors totaling \$2,188,950 that required disclosure. Most of the identified debts were greater than \$500, and all remained outstanding during the reporting period in which they were incurred.

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff discussed these debts with a CRP representative and provided relevant work papers. The representative stated that he would review the matter.

The Audit staff recommends that, within 30 calendar days of service of this report, CRP amend its reports to disclose these debts and obligations on Schedules D.

Finding 3. Extension of Credit by a Commercial Vendor

Summary

After reviewing and analyzing disbursement records during audit fieldwork, the Audit staff noted that an incorporated vendor appeared to make a prohibited contribution to CRP by extending credit beyond its normal course of business and by failing to make commercially reasonable attempts to collect \$1,171,002 for services rendered. The Audit staff recommends that CRP provide documentation demonstrating that the credit extended to CRP was in the vendor's ordinary course of business and that the vendor made reasonable attempts to collect these debts.

Legal Standard

A. Corporate Contributions Impermissible. A corporation is prohibited from making any contribution in connection with a federal election. 2 U.S.C. §441b(a).

B. Definition of Commercial Vendor. A commercial vendor is any person who provides goods or services to a candidate or political committee and whose usual and normal business involves the sale, rental, lease or provision of those goods or services. 11 CFR §116.1(c).

C. Extension of Credit by Commercial Vendor. A commercial vendor, whether or not it is a corporation, may extend credit to a candidate or political committee provided that:

- The credit is extended in the vendor's ordinary course of business; and
- The terms of the credit are similar to the terms the vendor observes when extending a similar amount of credit to a nonpolitical client of similar risk.

11 CFR §116.3(a) and (b).

Facts and Analysis

A. Facts

During fieldwork, the Audit staff identified an incorporated vendor that appeared to make a prohibited contribution to CRP by impermissibly extending credit beyond its normal course of business and by not providing documentation demonstrating that the vendor made commercially reasonable attempts to collect the debts. The vendor, Strategic Fundraising, Inc. (SFI), performed voter/donor file prospecting and telephone fundraising services for CRP. There are 297 invoices, totaling \$1,171,002, which were outstanding between 121 and 757 days. Several of these invoices, dated between October and December 2006, were outstanding for services rendered during the 2006 election cycle. CRP paid all invoices between March and October 2007 and also in November 2008. Other than the initial invoices, CRP made no other documentation available to demonstrate that SFI made further attempts to collect these debts.

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff discussed this matter with a CRP representative and provided relevant work papers for review. The representative stated that he would review the matter.

The Audit staff had questions regarding SFI's billing and payment practices; therefore, a copy of the SFI vendor contract was requested. In response, CRP provided the contract and a letter from SFI addressing the extension of credit. The contract contained the following pertinent provisions:

- While SFI was responsible for planning, preparing, managing and conducting all telephone fundraising efforts directed at both previous and prospective donors, CRP was responsible for collecting, depositing and recording all contributions generated by SFI and providing SFI with regular reports "identifying all individuals who contributed to the Committee as a result of SFI's efforts, along with the amount and date of each contribution."
- SFI shall invoice CRP weekly, and CRP shall pay all invoices within 30 days of the invoice date and pay all prospecting invoices upon receipt.
- Outstanding balances 30 days past due shall accrue interest of 1 ½ % compounded monthly.

- The prospective donor fundraising section included a "Break-Even Guarantee," whereby in exchange for the right to be CRP's exclusive telephone fundraising firm, SFI agreed to cover the costs of all calls to prospective contributors. As such, CRP was not expected to pay more for prospecting calls than the sum of all actual contributions generated by those calls. The Guarantee included a provision in which the parties acknowledged that SFI was "accepting significant business risk" by extending the Guarantee to CRP and provided partial mitigation of the risk by granting SFI the exclusive right to conduct CRP's fundraising programs over the course of an entire year.
- SFI would be paid for its prospecting services at "an amount equal to the gross receipts generated by each prospecting project." In addition, if the "cumulative gross proceeds from all Prospecting campaigns performed in a calendar year exceeded the total of all prospecting calls... the positive difference [would] be credited to the Committee."

The letter from SFI states that credit was extended to CRP because it, as well as many of SFI's other Republican Party clients, was unable to engage in sustainable new donor acquisition, renewal and reactivation of old donors as a result of the external political climate at the time. SFI further states that it believed at all times that this extension of credit would further CRP's receipt of new funding, and that at no time did it intend to make a contribution by virtue of its extension of credit. SFI contends that the extension of credit was in its ordinary course of business, and that it followed its established procedures and its past practice with other telephone fundraising clients in the political arena in approving the extension of credit. SFI further adds that CRP and SFI negotiated a resolution of disputed billing items by devising a payment plan that involved its continued telephone fundraising for CRP and retention against the outstanding but unpaid balances of receipts until the obligation was satisfied in 2009. SFI contends that it received reasonable, prompt payment in full from CRP based on this extension of credit.

After consideration of all the aspects of this matter, the Audit staff suggests that there are two separate and distinct issues to be considered. First, CRP must establish that SFI's extension of credit was in its ordinary course of business. Second, if the first provision is met, CRP must demonstrate that SFI made commercially reasonable attempts to collect the debts. If CRP does not establish either provision, a prohibited contribution will result.

Ordinary Course of Business

In determining whether an extension of credit was in the ordinary course of business, the Commission considers whether the vendor followed established procedures and past practices, whether the vendor received prompt payment in full for previous extensions of credit, and whether the extension of credit conformed to the usual and normal practice in the industry (11 CFR §116.3(c)).

In considering similar fundraising agreements, the Commission has sought to determine whether an extension of credit was in a vendor's ordinary course of business by considering the presence of adequate vendor safeguards. The Commission has required committees to have safeguards in place to ensure that committees, in fact, pay for all the

costs of the fundraising programs. See MUR 5635 (Conservative Leadership PAC); AO 1991-18 (New York State Democratic Committee); AO 1976-36 (Committee for Fauntroy). Safeguards proposed by the Commission have included requiring advance deposits by a committee to reimburse vendors for potential shortfalls, limiting the term of the contract, or allowing vendors to terminate the contract early and demand full payment as a result of poor fundraising performance.

The terms of the "Break Even Guarantee" and the exclusivity clause in the contract raise a question of whether SFI's extension of credit to CRP was in its ordinary course of business. The Guarantee appears very similar to the type of "no-risk" or "limited-risk" provisions that, in previous matters, the Commission has found could constitute in-kind contributions in the absence of safeguards ensuring that (1) the committee would pay for all of the costs of the fundraising programs and (2) the vendor would bear all of the financial risk of programs not paying for themselves (MUR 5635; AO 1991-18; AO 1979-36). However, unlike the previous cases, SFI was not responsible for the "caging" of contributions resulting from its fundraising activity. The contract outlines that contributions were to be sent to CRP, which was supposed to deposit them in its own account and then pay the invoiced amounts to SFI. This provision, in combination with the Guarantee, raises questions as to whether the arrangement between CRP and SFI was one in which "the committee retain[ed] contribution proceeds while giving up little, or assum[ing] little to no risk with the vendor bearing all, or nearly all the risk." See AO 1991-18 (New York State Democratic Party). It appears that the exclusivity clause was included to offset any risk that prospecting calls would not generate contributions sufficient to cover SFI's costs in making them. This raises a question regarding whether this clause provided sufficient financial value to SFI such that it negated SFI's assumption of the risk that it would lose money on the prospecting calls. However, absent additional information showing that the value of the exclusivity clause was comparable to SFI's financial risk or that "no-risk" or "limited-risk" agreements such as the Guarantee between CRP and SFI conform to the usual and normal practices in the telemarketing industry, the Audit staff concludes that SFI did not extend credit to CRP in its ordinary course of business.

Commercially Reasonable Debt Collection

Even where an extension of credit by a commercial vendor is legally permissible when made, it may evolve into a contribution over time through the lack of commercially reasonable attempts on the part of the vendor to collect the resulting debt. The Commission determines that these attempts are commercially reasonable if the vendor has pursued its remedies as vigorously as it would pursue its remedies against a non-political debtor in similar circumstances (11 CFR §116.4(d)(3)). In this matter, it appears that many of the debt collection provisions outlined in the contract were not fulfilled.

- As previously mentioned, other than initial invoices, no other documentation was made available to demonstrate that CRP was billed weekly or that any further attempts were made to collect these debts.
- No documentation was presented to the Audit staff to demonstrate that CRP was billed the 1 ½ % interest, compounded monthly, for its debts outstanding more than 30 days.

In regard to the letter submitted by SFI, SFI admits that credit was extended to CRP and other political clients. It also mentions a negotiated repayment plan; however, this has never been discussed with the Audit staff nor presented to the Audit staff for review.

The Audit staff recommends that, within 30 calendar days of service of this report, CRP provide documentation or any other comments to demonstrate that SFI extended credit to CRP in its ordinary course of business. The documentation should include, but not be limited to, evidence that (1) the "Break Even Guarantee" within the SFI contract is common industry practice, (2) verification that the value of the exclusivity clause provided sufficient financial value to SFI such that it negated SFI's assumption of the risk that it would lose money on the prospecting calls, (3) confirmation that the terms of the credit are similar to the terms SFI observes when extending a similar amount of credit to a nonpolitical client of similar risk.

The Audit staff also recommends that, within 30 calendar days of service of this report, CRP provide documentation or any other comments to demonstrate that SFI made commercially reasonable attempts to collect these debts. The documentation should include, but not be limited to, evidence supporting the negotiated payment plan and examples of other SFI customers or clients of similar risk for which similar services had been provided and similar billing arrangements had been utilized. CRP should also provide documentation concerning SFI's billing policies for similar clients and work, advance payment policies, debt collection policies, and billing cycles.

Absent such a demonstration, the Audit staff will consider the \$1,171,002 an impermissible contribution from SFI.